

# SANITARY AND IMPROVEMENT DISTRICTS

## OVERVIEW

Sanitary and Improvement Districts (SID's) are authorized under Nebraska State Law as a vehicle for private developers to finance infrastructure improvements for land development. The district created, becomes a separate legal entity much like an incorporated town or village, but with more limited powers. The SID can issue debt instruments (warrants or bonds) sold by investment bankers to investors. The money raised must be used specifically for the purpose intended. Funds from the sale of debt instruments can be used to finance improvements within the boundaries of a private development to include:

- Land grading.
- Streets and roadways.
- Water and sanitary sewer facilities.
- Storm sewers.
- Parks and public right away.

An SID does not provide for its own police or fire protection or for public schools, but contracts for these services from nearby districts or municipalities. An SID can build its own water source (wells and storage tanks) or its own sewage treatment facility. Most often however, the SID will hookup to adjacent utility services provided by a municipality.

When formed, SID's are located outside city limits. In most cases, however, SID's are created with the intent that they will eventually annexed by the adjacent city or municipality. In order to facilitate annexation, the infrastructure improvements must be built with strict conformance to city zoning and code standards. Adjacent cities and municipalities have no obligation to annex SID's. Annexation of adjacent SID's is often attractive for a city since a well-developed SID adds to the city's tax base once the outstanding debt on the improvements is retired.

The primary risk to the formation of an SID is the sale of lots and the construction of residential and commercial buildings by end users. The proceeds from the sale of developed lots and the property tax revenues derived from the developed property provide the resources to repay the debt. If lots do not sell and the development does not progress in a timely manner, debt may not get repaid on schedule and the SID can go into bankruptcy. The discipline of incurring costs to develop property to achieve orderly lot sales and building construction represents the "art" and crux of determining the success or failure of an SID.

The outstanding indebtedness of an adjacent SID does not affect a city's credit rating. Once the SID is annexed by the city, the SID is extinguished and any remaining debt obligation is assumed by the city making the annexation. Assuming the debt burdens of poorly developed SID's through annexation can negatively impact a city's credit rating. Therefore, it is incumbent upon SID's to be developed with careful discipline. A well-developed SID allows for "self-financing" of infrastructure and increasing property values which can become valuable additions to a city through annexation.

Because city has zoning jurisdiction over SID's, the City can "control" the specifications of infrastructure installed.

**SID's are not designed to finance city-owned infrastructure.** Major trunk lines for water, sewer and storm sewer external to the development, are not financable through SID's. SID's can be used for either commercial or residential property development however, most SID's are used to finance residential development. For example, in Douglas and Sarpy Counties, in excess of 90% of residential developments are being financed through SID's.

SID financing requires a close working relationship by many specialists:

NAME	DESCRIPTION
Real Estate Developer	Individuals who develop, sell or lease commercial or residential property.
City County Planning Department	Ensures that SID projects adhere to design, zoning and code standards so that property developed as an SID can eventually be integrated into the city limits conforming to city standards.
Utility Providers	Public and private providers of utility services to include water, sanitary sewer, storm sewer, electricity and gas who coordinate the planning, construction and connection of services to the SID and within the SID once development commences.
Bond Underwriters	Investment banking firms underwrite the indebtedness to ensure that the costs incurred to build the SID are staged to maintain a financially viable project and a reliable payment source to the debt holders.
Investment Bankers	Investment firms that sell the indebtedness to investors.
Consulting Engineers	Engineering firms who design infrastructure improvements and ensure that installation meets city standards.
Accounting Firm	Accounting firms that specialize in handling the accounting for SID's.
Legal Council for SID	Represents the developer and the sanitary improvement district to ensure that the district is properly created and complies with appropriate laws and regulations.
Bond Underwriter's Council	A legal firm representing the Bond Underwriters that ensures the debt instruments are properly created, are secured by a first lien on the property and represent a valid and binding obligation of the SID, and related disclosures.

## LINCOLN'S EXPERIENCE

The Highlands: The Highlands subdivision was the last subdivision built in Lincoln using SID's. In the early 1980's, the Highland's SID was created. The SID eventually went into bankruptcy. The city of Lincoln annexed the property. Undeveloped land and land that was developed but not built upon, was purchased by private investors. Once annexed by the city and in the hands of a new private developer, the subdivision quickly turned around and is now an excellent development.

WHAT WENT WRONG?: Two things caused the failure of the Highland's SID. First, huge development costs were incurred well ahead of any lot sales or houses built. The debt burden became too great too fast. Secondly, the timing was bad. The early 1980's saw the highest level of interest rates in U.S. history resulting in a collapse of new construction. Consumers quit buying and building homes. As a result, land sales in the SID were not sufficient to carry the debt burden and the bonds went into default. After bankruptcy, the bondholders took a sizable loss on their investment in the SID debt. In annexing the subdivision, the City of Lincoln may have occurred some nominal cost to complete improvements however, it gained a sizable tax base that quickly grew once the development was back on track.

With the high interest rates of the 1980's and the collapse of the real estate market, many SID's failed. Even with properly staged construction and financial discipline, The Highland's SID would have likely gone into bankruptcy.

The State laws governing SID's have since been changed to incorporate greater integrity in the financial structuring of SID expenditures. (This change in law may need further investigation to determine exactly what the benefits are under the new law.)

Two groups were affected by the bankruptcy. First, the bondholders who invested in the debt to finance the improvements took significant losses on their investment. Typically, investors in SID's are financial institutions, insurance companies and other sophisticated investors. Secondly, the consumers who bought individual lots and those who built the first homes did so expecting that the development would be completed in a timely fashion. Because the development lagged, upkeep of vacant lots and land did not occur. The appearance of the property suffered. *Also may have paid higher taxes in early years.* Homeowners who had to sell homes during the early years of the SID may have had to accept below market prices for their properties due to the uncertainty created by the bankruptcy.

Pine Lake: In the 1960's , the area of Lincoln known as Pine Lake was developed as an SID. The SID provided many of the improvements within the development. Pine Lake has not been annexed by the City of Lincoln, but informal negotiations have been underway for possible annexation.

## ARE SID'S A MORE EFFICIENT WAY TO FINANCE THE BUILDING OF INFRASTRUCTURE?

The costs of the public infrastructure - arterial streets, water, storm sewer, sanitary sewer trunk lines located outside a subdivision - CANNOT be financed through an SID. The City must extend this infrastructure to the boundary of the subdivision at its cost.

*Therefore, SID's do not improve a City's ability to finance public infrastructure. SID financing does allow more developers to participate in land development. Currently, only*

*developers with sizeable financial resources can develop sizeable land tracts in and around Lincoln.*

Real estate developments that can be annexed from the beginning afford the City an immediate increased tax base as the property is developed. SID's on the other hand, result in a deferred tax base benefit since the outstanding indebtedness incurred by the developer through the SID must first be satisfied with tax revenues from the developed property.

#### **WHAT ARE THE RISKS OR CONCERNS TO A CITY?**

When a city annexes an SID, it assumes any outstanding debt of the SID. If the SID infrastructure is poorly constructed or not constructed to city standards, the city may have to invest in the SID to bring services up to standard. Debt assumption by a city can negatively impact its credit rating if the debt assumption is in greater proportion than value of property being added to the city's tax roles. → *Should not occur, since city can decide if SID is annexed!*

It is important to note that a city is under no obligation to annex an SID. While there may be political pressures from residents or politicians to take over a failed SID, there is no financial or moral obligation to do so. When a city does annex an SID, any outstanding debt against the SID becomes a general obligation debt of the city, so in essence the city adds to its debt burden without a vote of the taxpayers. The City also adds a tax base that should service that debt.

It is also worth noting that the City cannot collect sales taxes on building materials delivered outside the city limits.

#### **MOVING FORWARD**

There currently is nothing preventing a developer from pursuing SID financing for a new development other than City and County cooperation. Since several things have changed since Lincoln's last SID development, it **may** be time for a community forum to be held to re-examine the considerations for SID financing. Expertise is readily available in Lincoln and Omaha to thoughtfully examine this issue.

#### **Contacts for future reference:**

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The information contained in this pamphlet is not intended to constitute legal advice but rather is intended to provide general information concerning Sanitary and Improvement Districts. If you have any legal questions concerning Sanitary and Improvement Districts, then we would urge you to contact an attorney. If you are a resident of a Sanitary and Improvement District which this firm represents, then we would ask that you contact us if you have any legal questions concerning such Sanitary and Improvement District.

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## WHAT IS A SANITARY AND IMPROVEMENT DISTRICT?

A Sanitary and Improvement District is a municipal corporation, much like a small city or village, except that it does not have the police powers one normally associates with those entities, and in fact is specifically limited to certain functions. The primary function of a Sanitary and Improvement District is to install and maintain public improvements, i.e. streets, sewers, recreational facilities, water lines, electrical and gas mains and other improvements associated with residential, commercial and industrial subdivisions.

### FORMATION

A Sanitary and Improvement District is formed when the owners of real property file a petition with the Clerk of the District Court of the county in which the proposed Sanitary and Improvement District is to be located asking the District Court for a declaration for the formation of a Sanitary and Improvement District. Attached to the petition is a document entitled "Articles of Association" which includes the name of the District, the boundaries of the District, the names and addresses of the owners of the land in the District, a description of the land within the District owned by the organizers of the District, the purpose for forming the District and the name or names of owners of real estate within the District who do not join in the organization of the District. The Articles of Association are signed by all the owners of the property within the District who agree to its formation and wherein they agree that they are willing to and do obligate themselves to pay the tax or taxes which may be levied against all the properties in the District as well as any special assessments which may be levied against the property for the cost of construction of the public facilities to the extent of the special benefit thereof. Although the law theoretically permits the formation of a Sanitary and Improvement District by less than all the property owners within the boundaries of the proposed District, from a practical standpoint most, if not all

Sanitary and Improvement Districts have been formed with the consent of all the property owners.

### GOVERNING BODY

The original petition filed with the District Court names five owners of property within the District as its proposed original Board of Trustees. Upon the execution by the Court of a decree actually forming the District, these five people are declared to be the original Board of Trustees of the District and serve until the first election which occurs on the first Tuesday after the second Monday in September which is at least 15 months after the Judgment of the District Court creating the Sanitary and Improvement District. Thereafter, elections are held every two years on the same date. At the first election and at the election held two years thereafter, any person may cast one vote for each Trustee for each acre of unplatted land or fraction thereof and one vote for each platted lot which he/she/it may own in the District. The vote is tied to the property. If the land or lot is owned by a husband and wife as joint tenants or by any two or more individuals, there is still only one vote for that lot or each acre or fraction thereof for unplatted Trustees. At the election held four years after the first election of the legal property owners who reside within the boundaries of the Sanitary and Improvement District and three members shall be elected by all of the owners of real estate located within the District. At the election held eight years after the first election of Trustees, three members of the Board of Trustees shall be elected by the legal property owners who reside within such Sanitary and Improvement District and two by all owners of property within the District. Sanitary and Improvement Districts are, for the most part, formed by developers for the purpose of installing public improvements, subdividing the properties and selling the lots. In a residential subdivision, as lots are sold and residents move in, the purpose of the election statute is to give those persons who reside within the District an increasing voice in the affairs of the District as it develops.

Folking their election, Trustees shall meet and elect one of their number Chairperson and one of their number Clerk of the District. The Clerk shall be paid a salary not to exceed \$600/year. Each Trustee shall be paid \$3.00 for each meeting of said Board which he or she attends. The duties of the Board are (1) to adopt a seal, bearing the name of the District, (2) keep a record of all the Board's proceedings which shall be open to inspection by all owners of real estate in the District, (3) to pass all necessary ordinances, orders, rules and regulations for the necessary conduct of its business and to carry into effect the objects for which such Sanitary and Improvement District was formed, and (4) to appoint, employ and pay an engineer, attorney, fiscal agent and such clerical help as may be needed. If a vacancy occurs on the Board, the remaining Trustees may appoint a successor until the next regular or special election of Trustees. The County Treasurer is the Ex Officio Treasurer of all Sanitary and Improvement Districts within the County boundaries. All special assessments and all tax funds of the District are deposited with the County Treasurer.

## POWERS

The Sanitary and Improvement Districts have only a few of the powers that are normally given to cities and villages. The Board of Trustees is first limited by the purpose for which the District was formed as stated in the Articles of Association. The Articles of Association are, in turn, limited to those powers actually given to the District by statute. Those powers are:

- (a) To acquire, improve and operate public parks, playgrounds and recreational facilities.
- (b) To install and pay for a system of sidewalks, public roads, streets and highways, public waterways, docks or wharfs.
- (c) To install a water system or to contract for the installation and operation of a water system with a utilities district, municipality or corporation.

(d) To contract for water for fire protection and for resale to residents of the District.

(e) To contract for electricity for street lighting.  
(f) To install and pay for a sewer system, both sanitary and storm including, if necessary, the installation of a disposal plant, outfall sewer and lift station.

(g) To install gas and electric service lines and conduit.  
(h) To install civil defense warning systems.  
(i) To construct and contract for the construction of dikes and levees for flood protection for the District.

All of the above except for the water system, civil defense warning system, sanitary sewer system or sanitary and storm sewer or disposal plant, and gas or electric service lines and conduits have to be constructed wholly within the District.

Gas, water and electrical distribution systems are generally installed by the appropriate public utility and/or other local municipality. The District contracts with the public utility/municipality for the installation of the system. The public utility/municipality then usually charges the consumer direct for the product used (gas, water or electricity). In some instances, where there is no appropriate public utility/municipality (usually in the case of water), the District installs and operates these systems.

When the property owners within the District determine that an authorized public improvement is required, the Board of Trustees meets and considers the advisability of the improvement. Upon an affirmative vote of the Board of Trustees, the Board proposes the adoption of a "resolution of necessity". The "resolution of necessity" outlines the type of improvement proposed to be constructed, the engineers' estimate of the cost, the location of the improvement

and the, hodby which the cost of the improvement is to be paid. Several "resolutions of necessity" are usually adopted by a District—one for each type of proposed public improvement. In addition, the District is permitted to do the work in sections which might necessitate the adoption of more than one "resolution of necessity" for any particular overall project. For instance, it is not uncommon for a District to have several sections of paving improvements. The law requires that the proposed "resolution of necessity" be published in a "legal" newspaper within the County in which the District is located. After due publication and the posting of the proposed resolution within the property of the District, the Board of Trustees holds a public hearing. If a majority of owners representing the majority of the front footage which might be assessed for the cost of constructing the proposed improvement should object to the installation of the proposed improvement, then the resolution shall not be passed by the Board of Trustees.

After the approval of the "resolution of necessity", the Board then must advertise for bids for the proposed improvement and let a contract for the construction of the proposed improvement, after publication, to the lowest responsible bidder. The law requires that the responsible bidder shall provide the District with a duly approved Performance Bond guaranteeing completion and prompt performance of the contract.

#### FINANCING OF IMPROVEMENTS

Payment is made on progress estimates, generally issued on a monthly basis and approved by the Consulting Engineer employed by the District. The law provides that a maximum of 95% of the estimated costs are paid with at least 5% of all estimates withheld until the entire contract is completed and acceptance is recommended by the engineer, in writing, to the Board of Trustees. The District does not, of course, have cash funds with which to make progress

payments. In lieu of cash, payment is made by the issuance of warrants payable to the order of the contractor or anyone else performing authorized work for the District which are subsequently registered with the office of the County Treasurer so that they may be sold. The registration procedure is a simple one and in most instances, the County Treasurer merely certifies that there are no funds in the Construction Fund of the District to redeem the warrant. From the date of the registration of the warrant until the date called for payment, the warrant bears an interest at the rate designated on the face. Warrants that are issued for capital improvements of the District become due and payable no later than five years from the date of issuance and warrants that are issued for operation and maintenance expense of the District become due and payable no later than three years from the date of issuance. Warrants are generally outstanding from the date of issue until they are funded into bonds, unless previously called and acquired from funds derived from special assessments, taxes or other funds of the District. Interest on the warrants may be paid annually until such time as they are funded by bonds or otherwise redeemed by the issuance of additional warrants.

Inasmuch as most contractors will not accept warrants in lieu of payment unless they are guaranteed that the warrants will be converted into cash upon registration, the District enters into a contract with a municipal bondhouse which acts as the fiscal agent for the District. Prior to the commencement of any construction, most Districts contact several municipal bond organizations and obtain bids for the "purchase or placing" of warrants of the District given to contractors in lieu of cash. For performing this function and others, the fiscal agent is compensated by the receipt of a fee paid by the District. Municipal bond organizations which are active in the State of Nebraska are: Dain, Kalman & Quall Municipal-Nebraska, Inc., Kirkpatrick, Pettis, Smith, Polian, Inc. and Shearson Barney Hutton, Inc.

Upon completion and acceptance of the work called for in each "resolution of necessity", the engineers and attorney employed by

the District, prepare a schedule and plato of assessments. The special assessment taxes are levied for that part of the costs which are of special benefit to individual lots and parcels of land within the District. In this context, the special assessments are considered and passed by the Board of Trustees sitting as a Board of Equalization following the same rule as those of the most populous municipality whose zoning jurisdiction extends over the improvements. The law requires, in fact, that if the improvements of the District lie within the zoning jurisdiction of any city or village, then the Board of Trustees of the District, sitting as Board of Equalization, must serve notice upon the Clerk of the City that the special assessments are about to be levied, so that the city may interpose an objection to the method or amount of the special assessments to be levied by the District.

Once the special assessment taxes are actually levied, the remaining costs are considered to be the general benefit to all of the lots or parcels of land within the District and a general tax is levied for the payment of these costs. It should be noted that because the District is outside the corporate limits of any municipality, the resident of a District will not have to pay any tax imposed by the municipality on the residents of the municipality. However, the resident of the District will still be required to pay school district taxes and taxes of the county in which he resides, just as he would if he were a resident of the municipality. Like special assessments levied by a city or village, a period of time is allowed for payment of the amount of the specials in their entirety without interest. If no payments are made or if only a partial payment is made, the special levy is made payable in equal annual installments over a maximum 10-year period with interest on the installments at the rate of 10% per annum and 12% per annum if the installments become delinquent. Proceeds from the collection of the special assessments collected prior to the issuance of bonds may be applied towards redemption of outstanding warrants. Bonds are not generally issued by the District until after completion of all improvements and when the District's tax base has been established, i.e., sufficient number of homes/structures have been built, the

taxes from which are adequate to support the debt service requirements. In a large development, the bonds may be issued in several series to coincide with the development of the areas within the District. Bonds further provide for a certain period in which they may be called. This is an important consideration when the District lies close to the boundaries of a city or village that has a substantially better credit rating than the District which would enable the City, if the District is annexed, to call the bonds and reissue them at a lower rate. Generally, the call period on District bonds is five years.

All bonds are issued as general obligation bonds of the District. All monies collected from the special assessments that have been levied on the real estate within the District is set aside and constitutes a sinking fund for the payment of interest and principal of the bonds. The District is also required to levy a tax annually on all taxable property in the District, which together with the sinking funds derived from special assessments is sufficient to meet the payment of interest and principal on the bonds before they become due.

The municipality having zoning jurisdiction may at its option annex the District. If and when annexation occurs, the District merges with the City and the City succeeds to all the District's property, property rights, contracts and obligations of every kind. For example, any special assessments which the District has levied become the property of the City and if, at the time of annexation, the District shall not have entirely specially assessed the improvements made by the District within its boundaries then the City may proceed to levy the costs of such improvements to the same extent as the District may have levied them. Likewise, the general obligation bonds issued by the District prior to annexation become, after annexation, a general obligation of the annexing municipality. After annexation, the Board of Trustees of the District ceases to exist and the District in all respects becomes assimilated into the annexing municipality.

## - COMPARISON TO A MUNICIPALITY

Although Sanitary and Improvement Districts have been in use since the late 1940's, the laws governing them have changed during the years and misconceptions have arisen concerning Sanitary and Improvement Districts. The basis of most of the misconceptions is the failure to distinguish between the powers of a Sanitary and Improvement District and the powers of a municipality. Although both entities have limited powers, the Sanitary and Improvement District's powers are more restricted. The difference in restrictions between the two "political corporations" shows the limited purpose to which a Sanitary and Improvement District is designed.

The ability of a Sanitary and Improvement District to make rules and regulations governing people's conduct has not changed over the years. The Sanitary and Improvement District does not have the power to make any civil or criminal laws. Civil and criminal laws applicable to residents of the county in which the Sanitary and Improvement District is located also apply to the residents of the Sanitary and Improvement District.

The Sanitary and Improvement District does not have the power to establish zoning districts or to zone or rezone property or to establish building codes. If the Sanitary and Improvement District is within the zoning jurisdiction of a municipality, then that municipality's zoning and code regulations apply, even though the boundaries of the Sanitary and Improvement District are not within the boundaries of the municipality. If the boundaries of the Sanitary and Improvement District are not within the zoning jurisdiction of any municipality, then the zoning and code regulations of the county in which the Sanitary and Improvement District is located apply.

Like a city, the Sanitary and Improvement District has the power to acquire property through eminent domain. However, this power may only be used when it is necessary for its corporate

purposes, that is, only after the Board of Trustees has determined to make an authorized improvement, which will require that private property be taken, may the Sanitary and Improvement District exercise the power of eminent domain. This power may be used on property both within and outside of the District's boundary.

The Sanitary and Improvement District has the authority to employ an engineer, an attorney, an accountant, and clerical help, all of whom are removable at the discretion of the Board of Trustees.

A Sanitary and Improvement District may own land, just as a municipality, however, the Sanitary and Improvement District may not own land in excess of ten acres, unless the land is actually used for public purpose within three years of its acquisition.

In short, as previously stated, the major difference is that a Sanitary and Improvement District does not have the police powers normally associated with cities, towns and villages and is strictly limited to the installation, operation and maintenance of public improvements.